

DEPARTMENT OF STATE REVENUE

04-20170771.LOF

Letter of Findings Number: 04-20170771
Use Tax
For Tax Years 2011-13

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Business produced sufficient documentation to support its protest that some items included as taxable in the Department's use tax calculations were not taxable. However, some items under protest were properly subject to tax and will not be removed from the Department's calculations of tax due. Therefore, the Department will remove those items which were found to be not subject to tax and then recalculate the amount of use tax due. Waiver of penalty was not warranted.

ISSUES

I. Use Tax—Tangible Personal Property.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-8](#).

Taxpayer protests the imposition of use tax.

II. Tax Administration—Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of penalties.

STATEMENT OF FACTS

Taxpayer is an out-of-state business with operations in Indiana. As the result of an audit, the Indiana Department of Revenue ("Department") determined that for the tax years 2011, 2012, and 2013 ("Tax Years") Taxpayer had not paid sales tax on some purchases of tangible personal property ("TPP") at the time of purchase and had not remitted use tax on those purchases. The Department therefore issued proposed assessments for use tax, penalty and interest for the Tax Years. Taxpayer protested that some of the items of TPP included as taxable in the Department's calculations were not taxable and that the use tax assessments should be reduced. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax—Tangible Personal Property.

DISCUSSION

Taxpayer protests a portion of the proposed assessments for use tax for the tax years 2011-13. The Department based its proposed assessments on a review of Taxpayer's purchase documents. Since Taxpayer operates three separate locations ("Location One", "Location Two", and "Location Three") in Indiana, the Department reviewed purchases at each location separately, calculated the amount of use tax due at each location by use of a sample and projection method, then combined the resulting amounts of use tax due from each location into a single amount due from Taxpayer overall for each year at issue. In the sample and projection method, the Department selected a random sample of purchases of TPP during the Tax Years and used taxable purchases in the sample population upon which sales or use tax had been paid as the numerator and used total purchases in the sample population as the denominator. The resulting compliance rate was applied to total purchases for the Tax Years.

This process was used at each of the three Indiana locations.

Taxpayer protests that the Department listed some purchases which were not subject to sales tax or use tax incorrectly. Specifically, Taxpayer argues that certain purchases were listed as taxable but upon which neither sales tax nor use tax had been paid when in fact those transactions were either exempt or had actually had tax paid at the time of purchase. Listing these transactions as subject to tax but without tax paid, Taxpayer argues, resulted in higher taxable rates being applied to Taxpayer's total purchases. Prior to the administrative protest hearing, the Department reviewed Taxpayer's protest materials and agreed to reclassify some of the transactions listed as taxable in the Department's calculations of use tax due. Those adjustments will be incorporated into the conclusions of this Letter of Findings.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[w]hen [courts] examine a statute that an agency is 'charged with enforcing. . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

Sales tax is imposed by IC § 6-2.5-2-1, which states:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Use tax is imposed by IC § 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Also, [45 IAC 2.2-3-4](#) provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is used, stored, or consumed in Indiana, use tax is due unless sales tax was paid at the time of the transaction.

Location One:

In Taxpayer's protest regarding the sample and projection calculations for Location One, Taxpayer protests that entries for Stratum 2, Sort numbers 149, 236, 244, 248, and 249 were for purchases upon which sales tax was paid at the time of purchase. Also, Taxpayer states that entries for Stratum 3, Sort numbers 138, 143, 210, 217, 220, 222, and 226 were also for purchases upon which sales tax was paid at the time of purchase. Therefore, Taxpayer argues, use tax is not due upon those transactions under IC § 6-2.5-3-2(a) and they should be reclassified in the Department's use tax calculations. After review of the receipts for these transactions, the Department agrees with Taxpayer's protest regarding these transactions.

Also listed as a payment for Location One is an entry at Stratum 2, Sort number 155. Taxpayer states that this entry was for a sponsorship of a hole in a charity golf tournament. Therefore this was not a purchase of TPP and so was not subject to sales tax or use tax under IC § 6-2.5-2-1 and IC § 6-2.5-3-2(a). After review of the documentation supplied in the protest process, the Department agrees with Taxpayer's protest. The transaction was not for the sale of TPP and so was not subject to sales tax or use tax.

Finally, Taxpayer emphasized several purchases listed above as purchases for its workers' use including work shoes, hand soap, and ice and beverages in hot weather. The relevant regulation is [45 IAC 2.2-5-8](#) which provides in relevant parts:

...

(c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

-EXAMPLES-

...

(2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

...

(F) *Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.*

....
(Emphasis added).

While these purchases may be beneficial to Taxpayer's employees, invoices alone do not establish that these items were safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production, as required by [45 IAC 2.2-5-8](#). Therefore, since sales tax was paid on these transactions at the time of purchase they will be reclassified as not subject to use tax in the Department's calculations. However, Taxpayer will not also get a deduction of sales tax paid, since it has not been established that the items in question were exempt.

Location Two:

In Taxpayer's protest regarding the sample and projection calculations for Location Two, Taxpayer protests that entries for Stratum 2, Sort numbers 142, 151, 158, 182, 201, and 361 were for purchases upon which sales tax was paid at the time of purchase. Also, Taxpayer states that entries for Stratum 3, Sort numbers 157 and 250 were for purchases upon which sales tax was paid at the time of purchase. Also, Taxpayer states that entries for Stratum 4, Sort numbers 1, 34, and 147 were for purchases upon which sales tax was paid at the time of purchase. Therefore, Taxpayer argues, use tax is not due upon those transactions under IC § 6-2.5-3-2(a) and they should be reclassified in the Department's use tax calculations. After review of the receipts for these transactions, the Department agrees with Taxpayer's protest regarding these transactions.

Next, Taxpayer protests that the entry for Stratum 3, Sort number 8 was for non-taxable services. Also, Taxpayer protests that entries for Stratum 4, Sort numbers 32, and 84 were for non-taxable services. Additionally, Taxpayer protests that entries for Stratum 5, Sort number 16 was for non-taxable services. Therefore, Taxpayer argues, use tax is not due upon those transactions under IC § 6-2.5-3-2(a) and they should be reclassified in the Department's use tax calculations. After review of the receipts for these transactions, the Department agrees with Taxpayer's protest regarding these transactions.

Next, Taxpayer protests that the entry for Stratum 2, Sort number 17 had use tax accrued and remitted prior to the audit. Taxpayer supplied copies of the invoice, its internal use tax tracking records, and the Indiana sales and use tax return for the appropriate month. After review of this documentation, the Department agrees with Taxpayer's protest. Therefore this entry will be reclassified as not subject to use tax in the Department's calculations.

Finally, Taxpayer protests that the entry for Stratum 3, Sort number 400 represented a capital purchase. The Department's audit report explanation for this entry states, "CANT [sic] TELL WHAT THIS IS" and "NOT CLEAR WHO THIS IS." Taxpayer provided a copy of a screenshot of its internal accounting system which states the name of the other party involved in this entry. There is no other information other than "Capital Purchases" listed. Therefore, while Taxpayer has addressed the Department's audit concerns regarding who the other party was, Taxpayer has not explained what the entry is or why it is exempt. Taxpayer has not met the burden imposed by IC § 6-8.1-5-1(c) of proving this portion of the proposed assessments wrong.

Location Three:

In Taxpayer's protest regarding the sample and projection calculations for Location Three, Taxpayer protests that entries for Stratum 3, Sort numbers 21, 22, 28, 63, 64, 65, 66, 67, 68, 69, 70, and 71 were for purchases upon which sales tax was paid at the time of purchase. After review of the documentation supplied by Taxpayer in support of this position, the Department agrees with Taxpayer's protest.

Next, Taxpayer protests that entries for Stratum 2, Sort numbers 153, 154, 155, 156, 157, 166, 167, 168, 169, 170, 171, and 173 were for nontaxable services. Also, Taxpayer protests that entries for Stratum 3, Sort numbers 76, 77, 78, 79, 80, 81, 82, 83, 84, and 85 were for nontaxable services. After review of the documentation supplied by Taxpayer in support of its position, the Department agrees that these entries were for monthly maintenance services only without any transfer of TPP and were therefore not subject to sales tax or use tax under IC § 6-2.5-2-1 and IC § 6-2.5-3-2(a).

Next, Taxpayer protests that the entry for Stratum 3, Sort number 103 represented a charge for storage in another state. After review of the documentation supplied by Taxpayer in support of its position, the Department agrees that this entry was for services and that those services did not occur in Indiana and were therefore not subject to sales tax or use tax under IC § 6-2.5-2-1 and IC § 6-2.5-3-2(a). Next, Taxpayer protests that the entry for Stratum 3, Sort number 105 represented a charge for repairs performed in another state. After review of the documentation supplied by Taxpayer in support of its position, the Department agrees that this entry was for repair services and also that the service did not occur in Indiana and was therefore not subject to sales tax or use tax under IC § 6-2.5-2-1 and IC § 6-2.5-3-2(a).

Finally, Taxpayer protests that the entries for Stratum 4, Sort numbers 11, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, and 29 represented charges for rail car rental. Taxpayer states that the rail car rentals were nontaxable services. After review of the materials supplied by Taxpayer in its protest, the Department is convinced that these transactions are the same as one which was reclassified as nontaxable by the Department prior to the administrative hearing. Therefore, the Department will reclassify these entries as well.

Conclusion

Taxpayer is sustained on all portions of its protest except for the safety and comfort items listed in the sample population for Location One and the "Capital Purchases" for Location Two. The Department will reclassify all sustained protest items as nontaxable and will recalculate Taxpayer's compliance rate for each location, including those items approved for reclassification by the Department prior to the administrative hearing. The Department will then recalculate use tax due for each location and will produce new, reduced, assessments of use tax due from Taxpayer overall for the Tax Years.

FINDING

Taxpayer's protest is sustained in part and denied in part, as provided above.

II. Tax Administration—Negligence Penalty.

DISCUSSION

Taxpayer protests the imposition of penalties pursuant to IC § 6-8.1-10-2.1. Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. [45 IAC 15-11-2\(b\)](#) clarifies the standard for the imposition of the negligence penalty as follows:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at [45 IAC 15-11-2\(c\)](#) as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay

a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer protests the Department's assessment of penalties. Taxpayer states that it at all times exercised the level of reasonable care, caution, and diligence expected of an ordinary taxpayer. After review of the documentation and analysis provided in the protest process, the Department does not agree with Taxpayer's position. While Taxpayer has been sustained on the imposition of use tax on most of the protested transactions in Issue I above, it remains that Taxpayer had a significant amount of use tax due for the Tax Years. Therefore, waiver of penalties is not warranted under [45 IAC 15-11-2\(c\)](#). However, penalties will be recalculated after the base use tax is recalculated to reflect the lower amount of use tax due for the tax years.

FINDING

Taxpayer's protest to the imposition of penalties is denied.

SUMMARY

Taxpayer is sustained in part and denied in part in Issue I regarding the imposition of use tax. Taxpayer is denied in Issue II regarding the imposition of penalties.

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